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OCT 16 1996

Federal Communications Commission
Office of Secretary

DOCKET FILE COPY ORIGINAL

October 16, 1996

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Suite 222
Washington, D.C. 20554

RE: CC Docket No. 96-149 Implementation of the Non-Accounting Safeguards of Section 271 and 272 of the Communications Act of 1934, as amended; and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area

Dear Mr. Caton:

Today, October 16, 1996, Dr. Alfred E. Kahn, National Economic Research Associates; Judy Peppler, Director, U S WEST Long Distance; Richard Karre, Senior Attorney and the undersigned met with representatives from the Policy Division of the Common Carrier Bureau regarding issues raised in the above-referenced proceeding. The Policy Division was represented by Radhika V. Karmarkar, Attorney; Carol E. Mattey, Deputy Chief, Linda Kinney, Attorney; Sarah E. Whitesell, Attorney and Patrick J. DeGraba, Industry Economist. The Purpose of the meeting was to discuss the joint marketing and separate affiliate provisions of Section 272 of the Telecommunications Act of 1996. The attached charts were used during the discussion and the Statement of Professor Kahn and Timothy J. Tardiff was submitted.

In accordance with commission Rule 1.1206(a)(2), two copies of the letter are being filed with you for inclusion in the public record. Acknowledgement and date of receipt are requested. A duplicate of this transmittal letter is included for this purpose.

Please contact me if you have questions.

Sincerely,

Cyndie Eby

cc: Radhika V. Karmarkar
Carol Mattey
Linda Kinney
Sarah E. Whitesell
Patrick J. DeGraba

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STATEMENT OF ALFRED E. KAHN AND TIMOTHY J. TARDIFF

Joint Marketing, Personnel Separation and Efficient Competition Under the Telecommunications Act of 1996

Prepared for U S West

October 11, 1996

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Consulting Economists

STATEMENT OF ALFRED E. KAHN AND TIMOTHY J. TARDIFF

I. INTRODUCTION AND SUMMARY

The Telecommunications Act of 1996 establishes the conditions and a process for lifting the interLATA service restriction on the Bell operating companies. It does this mainly by requiring the BOCs to provide competitors with access to network elements and retail services for resale on a non-discriminatory basis and, when they are free to offer interLATA services in-region, to do so for three years only through a structurally separate financial affiliate. By so doing, the Act seeks to open both the local exchange and the interLATA markets to more effective competition.

In this statement, we address ourselves to three categories of competitive safeguards associated with the BOCs' entry into interLATA markets proposed by the Federal Communications Commission in its Notice of Proposed Rulemaking of July 17th, in CC Docket No. 96-149: (1) restrictions on the sharing of administrative and support services between BOC affiliates and (2) on joint marketing and (3) provisions to ensure competitive parity between LECs and IXCs.

From our reading of these tentative conclusions and the proposals of other parties to this proceeding, we perceive a danger that the Commission may go beyond the requirements of the Act in the presumed interest of ensuring equal competitive opportunities to the BOCs' rivals and in so doing frustrate the Act's essential intention to bring to all consumers of telecommunications services the full benefits of vigorous, deregulated competition.

We do not, in our exposition, presume to resolve the complex legal questions of whether the Commission's proposals go beyond or conflict with the letter of the Telecommunications Act. To the extent, however, that the requirements of the Act are subject to a range of discretion or the Commission proposes restrictions on the BOCs that go beyond what it requires, we propose to explain why those restraints would in our judgment be anti-competitive—however much they may serve to protect or further the interests of individual competitors. Specifically, we believe the Commission's tentative conclusion that the Act prohibits the sharing of administrative and support services between the individual BOCs and their separate affiliates and some of its proposed answers to questions it poses about the Act's provisions covering joint marketing are both unnecessary to preserve competition and likely to deny consumers its full benefits.

II. ECONOMIC PRINCIPLES AND THE INTENT OF THE ACT

There is no tenet of competitive policy more fundamental than the distinction between preserving competition and protecting competitors from competition. The former goal may well require regulatory intervention in circumstances where incumbent firms have the power and the incentive to exclude potentially equally efficient rivals from an opportunity to compete. One of us co-authored a book more than 40 years ago whose central thesis, clearly signaled by its title, was the compatibility between such governmental interventions to ensure "fair competition" with the promotion of effective competition itself.[1] At the same time, we recognized the possibility that those interventions might actually weaken competition by protecting less efficient competitors from superior efficiencies of incumbent firms arising, for example, from economies of scale or integration (or scope).

The Commission has explicitly recognized this distinction and laudably proclaimed its determination to pursue only the former goal and avoid the latter pitfall:

> ...the purpose...of the 1996 Act is not to ensure that entry shall take place irrespective of costs, but to remove...barriers...that inefficiently retard entry, and to allow entry to take place where it can occur efficiently. This entry policy is competitively neutral; it is pro-competition, not pro-competitor. (NPRM, CC Docket 96-98, par. 12).

We do not suggest that drawing this distinction in practice is a simple matter. The Telecommunications Act itself clearly reflects a highly complex balancing process attempting to draw that line. What we find troublesome is what we see as a tendency of the Commission's proposed interpretations to shift that balance in the direction of protecting competitors by

[1] Joel B. Dirlam and Alfred E. Kahn, *Fair Competition: The Law and Economics of Antitrust Policy,* Ithaca, NY: Cornell University Press, 1954.

intensifying and proliferating regulatory restrictions on freedom of the BOCs to take advantage of potential efficiencies—the very path it declared in Docket 96-98 it would not take.

The fundamental source of the perceived power of the incumbent LECs to forestall efficient competition is their control over the supply of inputs believed to be essential to their competitors. There are, fundamentally, two ways of eliminating the consequent perceived threat to competition. One—the course we took in dissolving AT&T—is simply to prohibit the putative monopolist's engaging in the competitive operations, thereby eliminating any incentive on its part to exercise its power to exclude or handicap rivals. While this solution may in some circumstances be the best one available, on balance, it is obviously also inherently anti-competitive: it protects rivals from unfair competition by flatly denying incumbents the right to compete with them at all.

Moreover, this solution precludes competition by integration—the invasion by companies of one another's markets by extending the scope of their several operations—which can be a most efficient and creative form of competition. And it is precisely this kind of mutual market interpenetration on which we expect to rely heavily to make telecommunications markets pervasively competitive—with the several providers of local exchange, toll, cellular, satellite, video and other information services, as well as of equipment of one kind or another, each exploiting its own distinctive economies of scope, offering bundles of these and other services in competition with one another.

The other—the solution adopted by the new Telecommunications Act and, incidentally, the path taken by the Commission in its Computer III decision—is to ensure access by competitors to essential inputs on terms that enable them to compete with the LECs if they are equally efficient, while leaving incumbent firms free to enter competitive markets.

Typically, accounting safeguards (cost allocations), separate subsidiary requirements and divestiture are alternatives to the equal access solution. Imposition of such requirements on top of equal access requirements should be undertaken only when the incremental gains from such additional protections of competitors outweigh the inefficiencies that flow from inhibiting the incumbent from taking full advantage of its potential economies of scope by engaging in competition by integration.

III. Sharing of Administrative and Support Services

In its NPRM, the Commission tentatively concludes that section 272(b)(3) of the Act "prohibits the sharing of in-house functions such as operating, installation, and maintenance personnel, including the sharing of administrative services that are permitted under Computer II if those services are performed in-house." In addition, it seeks comment on whether that section of the Act "prohibits the BOC and an affiliate from sharing the same outside services, such as insurance or pension services." (par. 62)

The Commission's basis for the first conclusion is the Act's requirement that the affiliate "shall have separate officers, directors, and employees from the BOC of which it is an affiliate" (section 272(b)(3)). We leave to others the legal question of whether that injunction does necessarily preclude an affiliate's purchasing administrative and support services from the BOC so long as it fully reimburses the BOC for its share of the costs—as the Commission has until now permitted under the rules established in Computer II. To the extent that the Act does not unequivocally do so, however, we urge the Commission to recognize that any more expansive reading of the restrictions would be not only unnecessary but anticompetitive.

It would be unnecessary because we are aware of no assertion by any party that the Commission's present rules, requiring cost reimbursement, do not suffice to preclude any cross-subsidization of one set of operations by the other. It would be anticompetitive because any prohibition of the BOCs sharing such services both in-house and outside would, by denying them opportunities for such cost savings, subject them to a wholly artificial cost disadvantage and protect their competitors from—and deny consumers the benefits of—the lower prices and superior service offerings that these savings would make possible.

The sharing of administrative and support services as well as such outside services as insurance and pension management among several products or divisions of an organization is a classic example of an economy of scope. Far from being uniquely available to the BOCs, it is fully available to their competitors: consider the far-flung operations of the IXCs, cable operators and wireless service providers and the freedom they enjoy to provide their diverse operations with services on a shared basis whenever and wherever that appears to be a more efficient way of doing business.

There are at least three other reasons why it would be anomalous—as well as anticompetitive—not only to go back to the fully separated subsidiary protection of Computer II (as the Act does require for a transitional period) but to make it even more stringent, as the Commission suggests here. The first is the Commission's own previous abandonment of the fully-separated-subsidiary requirement, for the very reasons we oppose its expansion here:

> we are allowing the sharing of administrative services...by the parent and the subsidiary on a cost reimbursement basis....This assumes, of course, the existence of an accounting system which accurately reflects the costs of administrative services provided by an affiliated entity. With an appropriate accounting system, whatever administrative efficiencies may exist are preserved. (Final Decision, par. 255, Docket No. 20828, released May 2, 1980.)

Second, the substitution of price caps for rate base/rate of return regulation since that time by the FCC, along with a substantial majority of states, has severely attenuated if not eliminated the major reason for the requirement—the concern that regulated companies might cross-subsidize competitive operations—by depriving them of any expectation of being able to recover losses on those operations from monopoly customers.

Finally, in moving from Computer II to Computer III, the FCC opted instead for the protection of requiring the BOCs to adopt open network architecture, under which competitors would have fair access to any of the Bell Companies' essential facilities. Now that Congress has in effect spelled out and expanded those ONA protections—while also retaining Computer II's fully separated subsidiary requirement on an interim basis—it becomes trebly anomalous for the FCC to propose in any way to make those latter requirements any more restrictive than the language of the statute explicitly requires.

In sum, it would not promote efficient competition to prevent one major group of companies from taking advantage of scope economies that all other companies currently enjoy or can develop, when there is so far as we are aware no basis for believing that the Commission's existing regulations are insufficient to protect the BOCs' rivals from unfair competition.

IV. Joint Marketing

The Act allows both BOCs and IXCs to market interLATA and local exchange services jointly, albeit with some restrictions on both clearly designed to ensure parity of competitive opportunities between them. A BOC may not engage in such joint marketing until (1) it is authorized by the FCC to offer interLATA service within its region and (2) other carriers may market and sell the BOC's local exchange services. Large IXCs are symmetrically restricted from jointly marketing their own interLATA services with local exchange services purchased from an LEC under the Act's resale provisions until the BOC is authorized to offer interLATA service or three years from the date of enactment, whichever is earlier.

In its NPRM, the FCC asks for comments on the following conditions relating to the BOCs': (1) corporate and financial arrangements necessary to comply with the Act's affiliate transaction requirements; (2) whether a BOC's interLATA affiliate must purchase marketing services from it on an arm's length basis; and (3) whether it is necessary instead to require a BOC and its affiliate to contract jointly with an outside entity to conduct such joint marketing. In addition, it tentatively concludes that the restriction on joint marketing by the IXCs applies to their combining interLATA service only with local exchange service purchased for resale, not when they provide local services via unbundled network elements purchased from LECs.

Here as elsewhere we make no effort to resolve the threshold legal issue whether the Act requires, or even allows, the Commission to restrict the BOCs in these ways. Our contention will be only that any such restrictions imposed differentially on them but not their rivals over and above those unequivocally stipulated in the statute would be unjustifiably protective of competitors and injurious to consumers.

It is widely understood that joint marketing is likely to be a central feature of competition in telecommunications services. In a recent J.D. Power study, two thirds of all consumers surveyed said they would prefer to buy all their telephone services from their interexchange service company.[2] Both the FCC and the Court of Appeals have found that the bundling of a variety of products and services and the one-stop shopping it makes possible is competitive, efficient and potentially beneficial to consumers.[3] Manifestly, that competition is

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[2] *Communications Daily*, 9/5/96, p. 4.

[3] Memorandum Opinion and Order, In Re Application of Craig O. McCaw, Transferor, and AT&T, Transferee, for Consent to the Transfer of Control of McCaw Cellular Communications, Inc. and Its Subsidiaries, 9 FCC Rcd 5836, ¶ 57 (September 19, 1994); SBC Communications v. FCC, 56 F. 3d 1484 (D.C. Cir. 1995).

severely diluted if one major group of potential offerers of such bundles is either prohibited from that practice or hampered with restrictions that are not necessary to protect competition.

So far as we are aware, only one party—LDDS—argues for a flat prohibition of the BOCs joint marketing of local and long-distance services. But all the IXCs endorse whatever restrictions the Commission suggests and are not shy about proposing others of their own.

Central to the rationale of any such restrictions—other than a naked desire to handicap one's competitor—must be a belief that if a BOC is permitted to market a bundle of services it will succeed in unfairly handicapping or excluding rival sellers of competitive services by in effect tying sales of those services to local exchange service, in which it is believed to have a monopoly; and that the only way of preventing the BOCs from suppressing competition in this way is to restrict their ability to market the package. But the obvious way to prevent any such anti-competitive tying is simply to see to it that competitors are themselves enabled to acquire and sell the assumedly monopolized tying product on the same terms as the BOCs themselves. This would enable them to offer the same bundled combinations of services as the BOCs on equal competitive terms, if they are equally efficient.

The latter course is the one that the Act has taken or ultimately envisions, by seeking to ensure that the present providers of interLATA service are able to acquire from the BOCs either (a) such basic local exchange network functions as they require to provide local exchange service themselves, using their own facilities in whole or in part, or (b) the retail services themselves, by purchase for resale, for bundling with their own offerings. In this way it clearly demonstrates its approval of such packaging; and by limiting the ability of large IXCs to do so until the BOCs are similarly freed, it demonstrates its goal is a symmetrical lifting of restrictions on both sides.

In this connection, the Commission's tentative decision in both Docket 96-98 and in par. 91 of NPRM 96-149 that this restriction on the IXCs applies only when they have purchased the local exchange services from LECs for resale and not when they do essentially the same thing by buying unbundled network elements seems to us totally in conflict with the competitive symmetry that this restriction clearly seeks to achieve. The packaging of local and interLATA services is simply too powerful a marketing tool to limit its availability even temporarily to only one of the two most significant groups of competitors.

In these circumstances, similarly, restrictions beyond existing affiliate transaction rules on the bundling of local and interexchange services by the BOCs are not only unnecessary to preserve equal competitive opportunities for equally efficient rivals. They would also be blatantly anti-competitive, because they would unnecessarily hamper the BOCs' ability to offer to consumers the same combinations of services, at prices reflecting the available economies of scope, as both the Act and the Commission have taken extraordinary pains to ensure their competitors will be able to offer.

The first specific question the Commission poses with respect to such joint marketing by BOCs and/or their affiliates is what corporate and financial arrangements are necessary for such activities to comply with the Act's affiliate transaction requirements. Our response is that the Commission's current affiliate transaction rules, which require affiliates to compensate the BOCs for joint marketing costs, are fully sufficient to eliminate the only possible threat to competition—namely, that joint marketing might be used as a device for the more competitive businesses escaping their proper share of marketing expenses.

The second question is whether a BOC's interLATA affiliate must purchase marketing services from it on an arm's length basis. In so far as such a requirement were merely to restate the Commission's present affiliate transaction rules, under which "arms-length" means only that the transfer must be at a compensatory price (see Computer II Final Decision, 77 FCC 2d at 482), the answer is clearly yes. If, however, it envisions such additional restrictions as that the affiliate seek competitive bids for its marketing services, rather than simply use the services of its affiliate, we would oppose it. Competitive bidding requirements makes sense when the regulated company is a monopolist <u>and</u> may use the acquisition of some of its services from affiliates at prices <u>above</u> competitive levels as a means of evading the regulatory limitation on its retail rates. Here, instead, the only legitimate concern of competitors is that their BOC or BOC-affiliated rival might obtain those marketing services at prices <u>below</u> cost: the Commission's present arm's-length rules (as well as its rate cap regulation of putatively monopolistic services) amply preclude any such cross-subsidization.

The third question is whether it is necessary to require a BOC and its affiliate to contract jointly with an outside entity for joint marketing of interLATA and local exchange service. We see absolutely no justification for any such requirement and observe that the FCC suggests none. So long as the BOCs are precluded from tying sales of the competitive services to sales of local exchange services in ways that exclude competitors and from cross-subsidizing the competitive sales in any way—both of which are accomplished by the other protections we have described—we see no reason for such additional, asymmetrical restrictions applicable to the BOCs and their affiliates.

The Commission's basis for suggesting this third restriction is the Act's requirement, to which we have already referred, that the affiliate "shall have separate officers, directors, and employees from the BOC" (Section 272(b)(3)). We fail to see how employees of the BOCs' local exchange and interLATA affiliates working together on a joint marketing project could be interpreted as entailing the use of "common employees," any more than could the Commission's suggested alternative—their jointly contracting to use a third party. By imposing a more costly way of doing business on the BOCs with no corresponding benefit in terms of preserving fair competition, the restriction would be anti-competitive and injurious to consumers.

The anti-competitive character of these various suggested asymmetries becomes especially clear when we contrast them with the strenuous efforts of the Act and the Commission to encourage entry of rivals into the local exchange market, where it may be presumed they will be aggressive competitors because they can by so doing obtain economies of scope and because their present market share is close to zero. For exactly the same reasons, the BOCs may be expected to be highly effective competitors in the interLATA market. But they will be able to deliver those promised benefits to consumers only if they are permitted to enter subject to no greater restraints than their rivals. (And it is of course the fact of their present zero market share that totally refutes any notion that the BOCs should be treated as though they have a "dominant" position in the interLATA market.)

V. CONCLUSION

The cost of asymmetrical regulation is that it has the tendency to prevent the outcome of competition being determined by the relative efficiency of the several competitors. The incumbent local exchange carriers have particular capabilities and efficiency advantages in the various possible telecommunications markets stemming from economies of integration or of scope uniquely available to them. The same is true of their various competitors, actual and potential. Efficient competition will depend critically on the freedom of each of the rivals to achieve such economies by adding services—local exchange services by interexchange carriers, cable companies and others; interLATA services by the BOCs; and whatever others, existing and innovative, all of them find it economical to add to their present offerings. It confers its benefits on consumers by leaving each rival free to take full advantage of those economies and reflect them in the attractiveness of the packages it offers to the public.

The FCC explicitly recognized this principle in replacing the separate subsidiary requirements for enhanced services of its Computer II decision with the unbundling requirements of Computer III: it concluded that the benefits from the RBOCs offering enhanced services in a way that more fully took advantage of potential scope economies outweighed the potential costs and risks that abandoning structural separations would entail.

Similarly, in evaluating any additional restrictions of the kind it is considering in this Docket, the Commission's critical task is to determine whether they are indeed necessary to ensure achievement of the central goal of the Act to open telecommunications markets to robust competition, to what extent instead they involve unnecessary and excessively intrusive regulatory handicapping of competitors. In our judgment the additional restrictions contemplated by the Commission that we evaluate here would go well past the point that separates protecting competition from destroying or suppressing it.

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Second, the substitution of price caps for rate base/rate of return regulation since that time by the FCC, along with a substantial majority of states, has severely attenuated if not eliminated the major reason for the requirement—the concern that regulated companies might cross-subsidize competitive operations—by depriving them of any expectation of being able to recover losses on those operations from monopoly customers.

Finally, in moving from Computer II to Computer III, the FCC opted instead for the protection of requiring the BOCs to adopt open network architecture, under which competitors would have fair access to any of the Bell Companies' essential facilities. Now that Congress has in effect spelled out and expanded those ONA protections—while also retaining Computer II's fully separated subsidiary requirement on an interim basis—it becomes trebly anomalous for the FCC to propose in any way to make those latter requirements any more restrictive than the language of the statute explicitly requires.

In sum, it would not promote efficient competition to prevent one major group of companies from taking advantage of scope economies that all other companies currently enjoy or can develop, when there is so far as we are aware no basis for believing that the Commission's existing regulations are insufficient to protect the BOCs' rivals from unfair competition.

IV. Joint Marketing

The Act allows both BOCs and IXCs to market interLATA and local exchange services jointly, albeit with some restrictions on both clearly designed to ensure parity of competitive opportunities between them. A BOC may not engage in such joint marketing until (1) it is authorized by the FCC to offer interLATA service within its region and (2) other carriers may market and sell the BOC's local exchange services. Large IXCs are symmetrically restricted from jointly marketing their own interLATA services with local exchange services purchased from an LEC under the Act's resale provisions until the BOC is authorized to offer interLATA service or three years from the date of enactment, whichever is earlier.

In its NPRM, the FCC asks for comments on the following conditions relating to the BOCs': (1) corporate and financial arrangements necessary to comply with the Act's affiliate transaction requirements; (2) whether a BOC's interLATA affiliate must purchase marketing services from it on an arm's length basis; and (3) whether it is necessary instead to require a BOC and its affiliate to contract jointly with an outside entity to conduct such joint marketing. In addition, it tentatively concludes that the restriction on joint marketing by the IXCs applies to their combining interLATA service only with local exchange service purchased for resale, not when they provide local services via unbundled network elements purchased from LECs.

Here as elsewhere we make no effort to resolve the threshold legal issue whether the Act requires, or even allows, the Commission to restrict the BOCs in these ways. Our contention will be only that any such restrictions imposed differentially on them but not their rivals over and above those unequivocally stipulated in the statute would be unjustifiably protective of competitors and injurious to consumers.

It is widely understood that joint marketing is likely to be a central feature of competition in telecommunications services. In a recent J.D. Power study, two thirds of all consumers surveyed said they would prefer to buy all their telephone services from their interexchange service company.[2] Both the FCC and the Court of Appeals have found that the bundling of a variety of products and services and the one-stop shopping it makes possible is competitive, efficient and potentially beneficial to consumers.[3] Manifestly, that competition is

[2] *Communications Daily*, 9/5/96, p. 4.

[3] Memorandum Opinion and Order, In Re Application of Craig O. McCaw, Transferor, and AT&T, Transferee, for Consent to the Transfer of Control of McCaw Cellular Communications, Inc. and Its Subsidiaries, 9 FCC Rcd 5836, ¶ 57 (September 19, 1994); SBC Communications v. FCC, 56 F. 3d 1484 (D.C. Cir. 1995).

severely diluted if one major group of potential offerers of such bundles is either prohibited from that practice or hampered with restrictions that are not necessary to protect competition.

So far as we are aware, only one party—LDDS—argues for a flat prohibition of the BOCs joint marketing of local and long-distance services. But all the IXCs endorse whatever restrictions the Commission suggests and are not shy about proposing others of their own.

Central to the rationale of any such restrictions—other than a naked desire to handicap one's competitor—must be a belief that if a BOC is permitted to market a bundle of services it will succeed in unfairly handicapping or excluding rival sellers of competitive services by in effect tying sales of those services to local exchange service, in which it is believed to have a monopoly; and that the only way of preventing the BOCs from suppressing competition in this way is to restrict their ability to market the package. But the obvious way to prevent any such anti-competitive tying is simply to see to it that competitors are themselves enabled to acquire and sell the assumedly monopolized tying product on the same terms as the BOCs themselves. This would enable them to offer the same bundled combinations of services as the BOCs on equal competitive terms, if they are equally efficient.

The latter course is the one that the Act has taken or ultimately envisions, by seeking to ensure that the present providers of interLATA service are able to acquire from the BOCs either (a) such basic local exchange network functions as they require to provide local exchange service themselves, using their own facilities in whole or in part, or (b) the retail services themselves, by purchase for resale, for bundling with their own offerings. In this way it clearly demonstrates its approval of such packaging; and by limiting the ability of large IXCs to do so until the BOCs are similarly freed, it demonstrates its goal is a symmetrical lifting of restrictions on both sides.

In this connection, the Commission's tentative decision in both Docket 96-98 and in par. 91 of NPRM 96-149 that this restriction on the IXCs applies only when they have purchased the local exchange services from LECs for resale and not when they do essentially the same thing by buying unbundled network elements seems to us totally in conflict with the competitive symmetry that this restriction clearly seeks to achieve. The packaging of local and interLATA services is simply too powerful a marketing tool to limit its availability even temporarily to only one of the two most significant groups of competitors.

In these circumstances, similarly, restrictions beyond existing affiliate transaction rules on the bundling of local and interexchange services by the BOCs are not only unnecessary to preserve equal competitive opportunities for equally efficient rivals. They would also be blatantly anti-competitive, because they would unnecessarily hamper the BOCs' ability to offer to consumers the same combinations of services, at prices reflecting the available economies of scope, as both the Act and the Commission have taken extraordinary pains to ensure their competitors will be able to offer.

The first specific question the Commission poses with respect to such joint marketing by BOCs and/or their affiliates is what corporate and financial arrangements are necessary for such activities to comply with the Act's affiliate transaction requirements. Our response is that the Commission's current affiliate transaction rules, which require affiliates to compensate the BOCs for joint marketing costs, are fully sufficient to eliminate the only possible threat to competition—namely, that joint marketing might be used as a device for the more competitive businesses escaping their proper share of marketing expenses.

The second question is whether a BOC's interLATA affiliate must purchase marketing services from it on an arm's length basis. In so far as such a requirement were merely to restate the Commission's present affiliate transaction rules, under which "arms-length" means only that the transfer must be at a compensatory price (see Computer II Final Decision, 77 FCC 2d at 482), the answer is clearly yes. If, however, it envisions such additional restrictions as that the affiliate seek competitive bids for its marketing services, rather than simply use the services of its affiliate, we would oppose it. Competitive bidding requirements makes sense when the regulated company is a monopolist <u>and</u> may use the acquisition of some of its services from affiliates at prices <u>above</u> competitive levels as a means of evading the regulatory limitation on its retail rates. Here, instead, the only legitimate concern of competitors is that their BOC or BOC-affiliated rival might obtain those marketing services at prices <u>below</u> cost: the Commission's present arm's-length rules (as well as its rate cap regulation of putatively monopolistic services) amply preclude any such cross-subsidization.

The third question is whether it is necessary to require a BOC and its affiliate to contract jointly with an outside entity for joint marketing of interLATA and local exchange service. We see absolutely no justification for any such requirement and observe that the FCC suggests none. So long as the BOCs are precluded from tying sales of the competitive services to sales of local exchange services in ways that exclude competitors and from cross-subsidizing the competitive sales in any way—both of which are accomplished by the other protections we have described—we see no reason for such additional, asymmetrical restrictions applicable to the BOCs and their affiliates.

The Commission's basis for suggesting this third restriction is the Act's requirement, to which we have already referred, that the affiliate "shall have separate officers, directors, and employees from the BOC" (Section 272(b)(3)). We fail to see how employees of the BOCs' local exchange and interLATA affiliates working together on a joint marketing project could be interpreted as entailing the use of "common employees," any more than could the Commission's suggested alternative—their jointly contracting to use a third party. By imposing a more costly way of doing business on the BOCs with no corresponding benefit in terms of preserving fair competition, the restriction would be anti-competitive and injurious to consumers.

The anti-competitive character of these various suggested asymmetries becomes especially clear when we contrast them with the strenuous efforts of the Act and the Commission to encourage entry of rivals into the local exchange market, where it may be presumed they will be aggressive competitors because they can by so doing obtain economies of scope and because their present market share is close to zero. For exactly the same reasons, the BOCs may be expected to be highly effective competitors in the interLATA market. But they will be able to deliver those promised benefits to consumers only if they are permitted to enter subject to no greater restraints than their rivals. (And it is of course the fact of their present zero market share that totally refutes any notion that the BOCs should be treated as though they have a "dominant" position in the interLATA market.)

V. CONCLUSION

The cost of asymmetrical regulation is that it has the tendency to prevent the outcome of competition being determined by the relative efficiency of the several competitors. The incumbent local exchange carriers have particular capabilities and efficiency advantages in the various possible telecommunications markets stemming from economies of integration or of scope uniquely available to them. The same is true of their various competitors, actual and potential. Efficient competition will depend critically on the freedom of each of the rivals to achieve such economies by adding services—local exchange services by interexchange carriers, cable companies and others; interLATA services by the BOCs; and whatever others, existing and innovative, all of them find it economical to add to their present offerings. It confers its benefits on consumers by leaving each rival free to take full advantage of those economies and reflect them in the attractiveness of the packages it offers to the public.

The FCC explicitly recognized this principle in replacing the separate subsidiary requirements for enhanced services of its Computer II decision with the unbundling requirements of Computer III: it concluded that the benefits from the RBOCs offering enhanced services in a way that more fully took advantage of potential scope economies outweighed the potential costs and risks that abandoning structural separations would entail.

Similarly, in evaluating any additional restrictions of the kind it is considering in this Docket, the Commission's critical task is to determine whether they are indeed necessary to ensure achievement of the central goal of the Act to open telecommunications markets to robust competition, to what extent instead they involve unnecessary and excessively intrusive regulatory handicapping of competitors. In our judgment the additional restrictions contemplated by the Commission that we evaluate here would go well past the point that separates protecting competition from destroying or suppressing it.

Ex Parte Presentation

October 16-17, 1996